THE PROBLEM OF THE RUPEE:
ITS ORIGIN AND ITS SOLUTION
(HISTORY OF INDIAN CURRENCY & BANKING)

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DEDICATED TO THE MEMORY OF
MY
FATHER AND MOTHER
AS A TOKEN OF MY ABIDING GRATITUDE FOR THE
SACRIFICES THEY MADE AND THE ENLIGHTENMENT
THEY SHOWED IN THE MATTER OF MY EDUCATION.

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PREFACE TO THE SECOND IMPRESSION

THE PROBLEM OF THE RUPEE was first published in 1923. Ever since its publication it has had a great demand : so great that within a year or two the book went out of print. The demand for the book has continued, but unfortunately I could not bring out a second edition of the book for the reason that my change-over from economics to law and politics left me no time to undertake such a task. I have, therefore, devised another plan : it is to bring out an up-to-date edition of the History of Indian Currency and Banking in two volumes, of which *The Problem of the Rupee* forms volume one. Volume two will contain the History of Indian Currency and Banking from 1923 onwards. What is therefore issued to the public now is a mere reprint of *The Problem of the Rupee* under a different name. I am glad to say that some of my friends who are engaged in the field of teaching economics have assured me that nothing has been said or written since 1923 in the field of Indian Currency which calls for any alteration in the text of *The Problem of the Rupee* as it stood in 1923. I hope this reprint will satisfy the public partially if not wholly. I can give them an assurance that they will not have to wait long for volume two. I am determined to bring it out with the least possible delay.

B. R. AMBEDKAR

Rajagraha,
Bombay,
7-5-1947.

PREFACE TO THE FIRST EDITION

In the following pages I have attempted an exposition of the events leading to the establishment of the exchange standard and an examination of its theoretical basis.

In endeavouring to treat the historical side of the matter, I have carefully avoided repeating what has already been said by others. For instance, in treating of the actual working of the exchange standard, I have contented myself with a general treatment just sufficiently detailed to enable the reader to follow the criticism I have offered. If more details are desired they are given in all their amplitude in other treatises. To have reproduced them would have been a work of supererogation; besides it would have only obscured the general trend of my argument. But in other respects, I have been obliged to take a wider historical sweep than has been done by other writers. The existing treatises on Indian currency do not give any idea, at least an adequate idea, of the circumstances which led to the reforms of 1893. I think that a treatment of the early history is quite essential to furnish the reader with a perspective in order to enable him to judge for himself the issues involved in the currency crisis and also of the solutions offered. In view of this, I have gone into that most neglected period of Indian currency extending from 1800 to 1893. Not only have other writers begun abruptly the story of the exchange standard, but they have popularised the notion that the exchange standard is the standard originally contemplated by the Government of India. I find that this is a gross error. Indeed, the most interesting point about Indian currency is the way in which the gold standard came to be transformed into a gold exchange standard. Some old, but by now forgotten, facts had therefore, to be recounted to expose this error.

On the theoretical side, there is no book but that of Professor Keynes which makes any attempt to examine its scientific basis.
But the conclusions he has arrived at are in sharp conflict with those of mine. Our differences extended to almost every proposition he has advanced in favour of the exchange standard. This difference proceeds from the fundamental fact, which seems to be quite overlooked by Professor Keynes, that nothing will stabilise the rupee unless we stabilise its general purchasing power. That the exchange standard does not do. That standard concerns itself only with symptoms and does not go to the disease : indeed, on my showing, if anything, it aggravates the disease.

When I come to the remedy, I again find myself in conflict with the majority of those who like myself are opposed to the exchange standard. It is said that the best way to stabilise the rupee is to provide for effective convertibility into gold. I do not deny that this is one way of doing it. But, I think, a far better way would be to have an inconvertible rupee with a fixed limit of issue. Indeed, if I had any say in the matter, I would propose that the Government of India should melt the rupees, sell them as bullion and use the proceeds for revenue purposes and fill the void by an inconvertible paper. But that may be too radical a proposal, and I do not therefore press for it, although I regard it as essentially sound. in any case, the vita! point is to close the Mints, not merely to the public, as they have been, but to the Government as well. Once that is done, I venture to say that the Indian currency, based on gold as legal tender with a rupee currency fixed in issue, will conform to the principles embodied in the English currency system.

It will be noticed that I do not propose to go back to the recommendations of the Fowler Committee. All those, who have regretted the transformation of the Indian currency from a gold standard to a gold exchange standard, have held that everything would have been all right if the Government had carried out *in toto* the recommendations of that Committee. I do not share that view. On the other hand, I find that the Indian currency underwent that transformation *because* the Government carried out those recommendations. While some people regard that Report as classical for its wisdom, I regard it as classical for its nonsense. For I find that it was this Committee which, while recommending a gold standard, also recommended and thereby perpetuated the folly of the Herschell Committee, that Government should coin rupees on its own account according to that most naive of currency principles, the requirements of the public, without realising that the latter recommendation was destructive of the former. Indeed, as I argue, the principles of the Fowler Committee must be given up, if we are to place the Indian currency on a stable basis.

I am conscious of the somewhat lengthy discussions on currency principles into which I have entered in treating the subject. My justification of this procedure is two-fold. First of all, as I have differed so widely from other writers on Indian currency, I have deemed it necessary to substantiate my view-point, even at the cost of being charged with over-elaboration. But it is my second justification, which affords me a greater excuse. It consists in the fact that I have written primarily for the benefit of the Indian public, and as their grasp of currency principles does not seem to be as good as one would wish it to be, an over-statement, it will be agreed, is better than an understatement of the argument on which I have based my conclusions.

Up to 1913, the Gold Exchange Standard was not the avowed goal of the Government of India in the matter of Indian Currency, and although the Chamberlain Commission appointed in that year had reported in favour of its continuance, the Government of India had promised not to carry its recommendations into practice till the war was over and an opportunity had been given to the public to criticize them. When, however, the Exchange Standard was shaken to its foundations during the late war, the Government of India went back on its word and restricted, notwithstanding repeated protests, the terms of reference to the Smith Committee to recommending such measures as were calculated to ensure the stability of the Exchange Standard, as though that standard had been accepted as the last word in the matter of Indian Currency. Now that the measures of the Smith Committee have not ensured the stability of the Exchange Standard, it is given to understand that the Government, as well as the public, desire to place the Indian Currency System on a sounder footing. My object in publishing this study at this juncture is to suggest a basis for the consummation of this purpose.

I cannot conclude this preface without acknowledging my deep sense of gratitude to my teacher, Prof. Edwin Cannan, of the University of London (School of Economics). His sympathy towards me and his keen interest in my undertaking have placed me under obligations which I can never repay. I feel happy to be able to say that this work has undergone close supervision at his hands, and although he is in no way responsible for the views I have expressed. I can say that his severe examination of my theoretic discussions has saved me from many an error. To Professor Wadia, of Wilson College, I

am thankful for   cheerfully undertaking the dry task of correcting the proofs.

FOREWORD
BY PROFESSOR EDWIN CANNAN

I am glad that Mr. Ambedkar has given me the opportunity of saying a few words about his book.

As he is aware, I disagree with a good deal of his criticism. In 1893, I was one of the few economists, who believed that the rupee could be kept at a fixed ratio with gold by the method then proposed, and I did not fall away from the faith when some years elapsed without the desired fruit appearing (see *Economic Review,* July 1898, pp. 400—403). I do not share Mr. Ambedkar's hostility to the system, nor accept most of his arguments against it and its advocates. But he hits some nails very squarely on the head, and even when I have thought him quite wrong, I have found a stimulating freshness in his views and reasons. An old teacher like myself learns to tolerate the vagaries of originality, even when they resist "severe examination " such as that of which Mr. Ambedkar speaks.

In his practical conclusion, I am inclined to think, he is right. The single advantage, offered to a country by the adoption of the gold-exchange system instead of the simple gold standard, is that it is cheaper, in the sense of requiring a little less value in the shape of metallic currency than the gold standard. But all that can be saved in this way is a trifling amount, almost infinitesimal, beside the advantage of having a currency more difficult for administrators and legislators to tamper with. The recent experience both of belligerents and neutrals certainly shows that the simple gold standard, as we understood it before the war, is not fool-proof, but it is far nearer being fool-proof and knave-proof than the gold-exchange standard. The percentage of administrators and legislators who understand the gold standard is painfully small, but it is and is likely to remain ten or twenty times as great as the percentage which understands the gold-exchange system. The possibility of a gold-exchange system being perverted to suit some corrupt purpose is very considerably greater than the possibility of the simple gold standard being so perverted.

The plan for the adoption of which Mr. Ambedkar pleads, namely that all further enlargement of the rupee issue should be permanently prohibited, and that the mints should be open at a fixed price to importers or other sellers of gold, so that in course of time India would have, in addition to the fixed stock of rupees, a currency of meltable and exportable gold coins, follows European precedents. In eighteenth-century England the gold standard introduced itself because the legislature allowed the ratio to remain unfavourable to the coinage of silver: in nineteenth-century France and other countries it came in because the legislatures definitely closed the mints to silver, when the ratio was favourable to the coinage of silver. The continuance of a mass of full legal tender silver coins beside the gold would be nothing novel in principle, as the same thing, though on a somewhat smaller scale, took place in France, Germany, and the United States.

It is alleged sometimes that India does not want gold coins. I feel considerable difficulty in believing that gold coins of suitable size would not be convenient in a country with the climate and other circumstances of India. The allegation is suspiciously like the old allegation that the " Englishman prefers gold coins to paper," which had no other foundation than the fact that the law prohibited the issue of notes for less than £ 5 in England and Wales, while in Scotland, Ireland, and almost all other English-speaking countries, notes for £ 1 or Less were allowed and circulated freely. It seems much more likely that silver owes its position in India to the decision, which the Company made before the system of standard gold and token silver was accidentally evolved in 1816 in England, and long before it was understood, and that the position has been maintained, not because Indians dislike gold, but because Europeans like it so well that they cannot bear to part with any of it.

This reluctance to allow gold to go to the East is not only despicable from an ethical point of view. It is also contrary to the economic interest not only of the world at large, but even of the countries, which had a gold standard before the war and have it still or expect soon to restore it. In the immediate future, gold is not a commodity, the use of which it is desirable for these countries either to restrict or to economize. From the closing years of last century it has been produced in quantities much too large to enable it to retain its purchasing power and thus be a stable standard of value, unless it can constantly be finding existing holders willing to hold larger stocks, or fresh holders to hold new stocks of it. Before the war, the accumulation of hoards by various central banks in Europe took off a large part of the new supplies and prevented the actual rise of general prices being anything like what it would otherwise have been, though it was serious enough. Since the war, the Federal Reserve Board, supported by all Americans who do not wish to see a rise of prices, has taken on the new " White Man's Burden " of absorbing the products of the gold mines, but just as the United States failed to keep up the value of silver by purchasing it, so she will eventually fail to keep up the value of gold. in spite of the opinion of some high authorities, it is not at all likely that a renewed demand for gold reserves by the central banks of Europe will come to her assistance. Experience must gradually be teaching even the densest of financiers that the value of paper currencies is not kept up by stories of " cover " or " backing " locked up in cellars, but by due limitation of the supply of the paper. With proper limitation, enforced by absolute convertibility into gold coin which may be freely melted or exported, it has been proved by theory and experience that small holdings of gold are perfectly sufficient to meet all internal and international demands. There is really more chance of a great demand from individuals than from the banks. It is conceivable that the people of some of the countries, which have reduced their paper currency to a laughing stock, may refuse all paper and insist on having gold coins. But it seems more probable that they will be pleased enough to get better paper than they have recently been accustomed to, and will not ask for hard coin with sufficient insistence to get it. On the whole, it seems fairly certain that the demand of Europe and European-colonised lands for gold will be less rather than greater than before the war, and that it will increase very slowly or not at all.

Thus, on the whole, there is reason to fear a fall in the value of gold and a rise of general prices rather than the contrary.

One obvious remedy would be to restrict the production of gold by international agreement, thus conserving the world's resources in mineral for future generations. Another is to set up an international commission to issue an international paper currency so regulated in amount as to preserve an approximately stable value. Excellent suggestions for the professor's classroom, but not, at present at any rate nor probably for some considerable period of time, practical politics.

A much more practical way out of the difficulty is to be found in the introduction of gold currency into the East. If the East will take a large part of the production of gold in the coming years it will tide us over the period which must elapse before the most prolific of the existing sources are worked out. After that we may be able to carry on without change or we may have reached the possibility of some better arrangement.

This argument will not appeal to those who can think of nothing but the extra profits which can be acquired during a rise of prices, but I hope it will to those who have some feeling for the great majority of the population, who suffer from these extra and wholly unearned profits being extracted from them. Stability is best in the long run for the community.

EDWIN CANNAN.

Chapter I